Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	AR&T Committee	Analyst:	Angela Raygoza	Bill Number:	AB 1580
Related Bills:	See Legislative History	Telephone:	845-7814	Introduced Date:	March 26, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Estimated Tax Withholding Rates/2009 Budget Bill Technical Clean-up

SUMMARY

This bill would clean-up several provisions from the recently enacted budget provisions, ABX3 3 (Evans, Stats. 2009, Third Extraordinary Session, Ch. 18), SBX3 15 (Calderon, Stats. 2009 Third Extraordinary Session, Ch. 17) and SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1), by doing the following:

1. Clarifying estimated tax payment percentages.
2. Clarifying the operative date for the dependent exemption credit,
3. Correcting cross referencing errors for the underpayment penalty, and
4. Clarifying the operative date of the apportionment factor.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to clarify and resolve issues related to the recently enacted budget trailer provisions to ensure effective implementation.

EFFECTIVE/OPERATIVE DATE

Provision 1: **Estimate Payments**

The estimated tax withholding provisions would be effective on January 1, 2010, and specifically operative for estimate payments due for each taxable year beginning on or after January 1, 2009, and specifically operative for amounts withheld on wages beginning on or after January 1, 2009.

Provision 2: **Dependent Exemption Credit**

The dependent exemption credit provision would be effective and operative on January 1, 2010.

Provision 3: **Underpayment Penalty of Estimated Tax**

The underpayment penalty provision would be effective and operative on January 1, 2010.

Provision 4: **Apportionment Factor**

The apportionment factor provision would be effective and operative on January 1, 2010.

Board Position:			Department Director	Date
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POSITION

Pending.

<u>PROVISION 1:</u> Estimate Payments

ANALYSIS

STATE LAW

In general, prior California law required individual and corporate taxpayers to remit four estimated tax payments each equal to 25 percent of their required annual payment. Newly enacted state law, SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1), changed the required applicable percentages so that the estimated tax payments for taxable years beginning on or after January 1, 2009, is now 30 percent, 30 percent, 20 percent, and 20 percent for the 1st, 2nd, 3rd, and 4th quarter installments, respectively.

Pre-existing state law requires the "annual payment" for an individual to be the lesser of the following:

- Option 1: 90 percent of the tax shown on the return for the taxable year, or
- Option 2: 100 percent of the tax shown on the return for the preceding taxable year.

In addition, pre-existing state law requires the annual payment under option 2 to be increased from 100 percent to 110 percent of the tax shown on the return if the adjusted gross income (AGI) of the taxpayer for the preceding taxable year exceeds $150,000 ($75,000 in the case of a married individual filing a separate return). Newly enacted state law (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1) modified the options above to provide additionally that a taxpayer with AGI equal to or greater than $1 million ($500,000 in the case of a married individual filing a separate return) may not use option 2 for taxable years beginning on or after January 1, 2009.

Under existing state law and unchanged by newly enacted state law (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch. 1), the "annualized income installment method" allows a taxpayer to calculate the required estimated tax payment based on an estimate of income, deductions and credits attributable to each installment period[1]. The computation of estimated tax payments under the "annualized income installment method" requires the annualized tax due for each installment period to be multiplied by an increasing percentage of 22.5 percent, 45 percent, 67.5 percent, and 90 percent. The percentages used in the calculation equate to 90 percent of 25 percent, 50 percent, 75 percent, and 100 percent of the required annual payment under Option 1.

Under previously existing state law and not explicitly changed by recently enacted state law, wage withholding is equally applied 25 percent, 25 percent, 25 percent, and 25 percent as quarterly installments toward a taxpayer's required annual payment.

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[1] A taxpayer whose income fluctuates throughout the year may have a lower required installment using the "annualized income installment method".

Generally, a taxpayer is subject to a penalty for any underpayment of estimated tax. The penalty is an amount equal to the underpayment rate multiplied by the amount of the underpayment. The underpayment rate is the same as the interest rate charged for tax delinquencies, currently 5 percent. The penalty is calculated by comparing the required amount for each estimated tax payment, determined under either the regular method (formerly 25 percent, 25 percent, 25 percent, 25 percent, now 30 percent, 30 percent, 20 percent, 20 percent) or the "annualized income installment method", with the amount paid by the due date of that installment.

THIS PROVISION

This provision would revise the percentages used to determine estimated tax payment requirements under the "annualized income installment method" to percentages consistent with recently enacted law. The percentages would be 27 percent, 54 percent, 72 percent, and 90 percent. These percentages equate to 30 percent, 60 percent, 80 percent, and 100 percent of the required annual payment --90 percent of the tax shown on the return for the taxable year.

In addition, this provision would explicitly state that wage withholding would be applied toward a taxpayer's estimated tax payment obligation using the percentages from recently enacted law that are 30 percent-30 percent -20 percent -20 percent.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would occur during the department's normal annual update.

OTHER STATES INFORMATION

Because this provision would clarify existing California law, a comparison of other states would be unnecessary.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This estimated tax payments provision would result in the following revenue gains:

Estimated Revenue Impact of AB 1580 As Introduced on March 26, 2009 Assumed Effective For Tax Years Beginning On or After January 1, 2010 Enactment after June 30, 2009 ($ in Millions)				
	2009-10	2010-11	2011-12	2012-13
Change withholding percentages	$0	$0	$0	$0
Modify percentages for "annualized income installment method"	+$60	+$12.0	+$2.0	+$8.0
Net Impact	+$60	+$12.0	+$2.0	+$8.0

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this provision.

Revenue Discussion

Change withholding percentages

The provision of this bill that would explicitly state that Franchise Tax Board (FTB) applies wage withholding in percentages consistent with the percentages required by SBX1 28 (Senate Committee on Budget, Stats. 2008, First Extraordinary Session, Ch.1) should not impact tax revenue. The department intends to apply wage withholding in percentages consistent with newly enacted law based on the Legislature's intent that wage withholding be applied in this manner.

Modify percentages for "annualized income installment method"

This provision modifies the percentages used to determine estimated tax payment requirements under the "annualized income installment method" to be consistent with the required percentages in newly enacted law. The revenue impact of this provision depends on the number of taxpayers that would avail themselves of the "annualized income installment method" and the amount of their estimated payments.

The impact of this provision would be the increase in the first two estimated payments for 2010. Assuming that ten percent of Personal Income Tax (PIT) estimated payments are made using the "annualized income installment method," approximately $400 million ($4 billion x 10%) in PIT estimated payments in April and June of 2010 would be expected to be made using this method under current law. It is assumed that if all of these estimated payments were adjusted to meet the new percentages under this proposal, the payments would increase from approximately $400 million to approximately $480 million ($400 million x 30%/25%). It is assumed that in 2010, approximately 75 percent of taxpayers using the "annualized income installment method" would increase their estimated tax payment from 25 percent to 30 percent of the annual payment required under newly enacted law. The amount of revenue that would be accelerated into 2009/10 would be approximately $60 million [75% compliance x ($480 million estimated payments under full compliance with this new provision - $400 million estimated payments under current law)]. Similar calculations were performed for fiscal years 2010/11 and 2011/12.

PROVISION 2: Dependent Exemption Credit

ANALYSIS

STATE LAW

Recently enacted state tax law, ABX3 3 (Evans, Stats. 2009, Third Extraordinary Session, Ch. 18), reduces the dependent exemption credit from $309 to $99 for taxable years 2009 and 2010.

THIS PROVISION

This provision would clarify that the reduction in the dependent exemption credit would cease to be operative for taxable years beginning on or after January 1, 2011, unless the Director of Finance notifies FTB of the result of the statewide election held during the 2009 calendar year, then the credit would cease to be operative on January 1, 2013.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would have no impact to the department.

FISCAL IMPACT

This provision would have no impact to the department.

ECONOMIC IMPACT

This provision would clarify existing law and would have no revenue impact.

PROVISION 3: Underpayment Penalty of Estimated Tax

ANALYSIS

STATE LAW

Recently enacted state tax law, SBX3 15 (Calderon, Stats. 2009, Third Extraordinary Session, Ch. 17), provides that a penalty for the underpayment of an installment of estimated tax is not imposed if the underpayment was created or increased by the disallowance of the jobs tax credit [2] because the allocated credit limit had been exceeded.

THIS PROVISION

This provision would correct a cross-referencing error in the recently enacted budget trailer bills, ABX3 15 and SBX3 15.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would have no impact to the department.

FISCAL IMPACT

This provision would have no impact to the department.

ECONOMIC IMPACT

This provision would clarify existing law and would have no revenue impact.

[2] R&TC 17053.80 and 23623- For taxable years beginning on or after January 1, 2009, allows a tax credit of $3,000 for each qualified full-time employee hired by a qualified employer above a baseline amount, determined on an annual full-time equivalent basis.

Provision 4: Apportionment Factor

ANALYSIS

STATE LAW

For taxable years beginning on or after January 1, 1993, the apportionment formula for most taxpayers has been a three-factor apportionment formula consisting of property, payroll, and double-weighted sales (three-factor, single-weighted sales, for certain taxpayers).

For taxable years beginning on or after January 1, 2011, recently enacted state tax law, SBX3 15 (Calderon, Stats. 2009, Third Extraordinary Session, Ch. 17), allows certain apportioning trades or businesses to make an annual, irrevocable election to utilize a single factor, 100 percent sales (single sales factor) apportionment formula instead of the three-factor, double-weighted sales, apportionment formula.

THIS PROVISION

This provision would clarify that the single sales factor election may be made by an apportioning trade or business for taxable years beginning on or after January 1, 2011.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would have no impact to the department.

FISCAL IMPACT

This provision would have no impact to the department.

ECONOMIC IMPACT

This provision would clarify existing law and would have no revenue impact.

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